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OFFICE OF  
CHIEF COUNSEL

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Dear :

This is in reply to your letter dated March 13, 2003, requesting a ruling to allow U.S. citizen employees of the U.S. Government abroad to claim a foreign tax credit for notional foreign taxes that are neither owed nor paid. Your letter indicates that the U.S. diplomatic mission in Sweden hires U.S. citizens living in Sweden. These U.S. citizens are paid a salary which is "netted down" because the Swedish government does not impose a tax on their salaries. The Embassy reduces the salaries paid to its locally-employed staff by the amount of tax that would have been paid to Sweden were they not tax exempt. This policy has resulted in U.S. citizen staff members receiving lower after-tax take-home pay than their non-citizen staff member colleagues, as all U.S. citizens (unlike Swedish citizens resident in Sweden) are obligated to pay U.S. federal income tax on their salaries. You inquired whether the IRS would issue a ruling providing that the "netted down" reduction in salary paid by the Department of State represents a *de facto* tax paid to Sweden, which could be claimed as a foreign tax credit by U.S. citizen locally-employed staff members on their U.S. federal income tax returns.

We hope the following general information regarding the foreign tax credit will be helpful to you. (This informational letter does not constitute a letter ruling. While it is the practice of the National Office of the Internal Revenue Service to issue letter rulings that interpret and apply the tax laws to a taxpayer's specific set of facts, certain procedural requirements set forth in Rev. Proc. 2003-1, 2003-1 I.R.B. 1 must be complied with in order to obtain a letter ruling. In other cases, the IRS may provide informational letters.)

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As a general matter, all U.S. citizens and residents are subject to U.S. federal income tax on their worldwide income. If a U.S. citizen or resident earns foreign source income and pays foreign income tax, he or she may credit that tax in the United States, thereby reducing his or her U.S. federal income tax liability. Specifically, subject to applicable limitations, section 901(a) of the Internal Revenue Code allows a credit against United States income tax for the amount of any income, war profits, and excess profits taxes paid or accrued to any foreign country during the taxable year. Generally, the following four tests must be met for any foreign tax to qualify for the credit.

1. The tax must be imposed on the U.S. taxpayer,
2. The U.S. taxpayer must have paid or accrued the tax,
3. The tax must be the legal and actual foreign tax liability of the U.S. taxpayer, and
4. The tax must be an income tax (or a tax in lieu of an income tax).

The fundamental purpose of the foreign tax credit provisions is to mitigate double taxation of income earned abroad by U.S. taxpayers. See American Chicle Co. v. United States, 316 U.S. 450, 452 (1942). Foreign income taxes must be both owed and actually paid to a foreign country to be allowed as a foreign tax credit. Treas. Reg. §§1.901-2 and 1.905-2. When no foreign tax is paid because a foreign country exempts a U.S. taxpayer's income from taxation under its domestic laws, there is no "double" tax to mitigate and therefore no foreign tax credit is allowable under section 901 of the Code. While we sympathize with the concerns outlined in your letter, the U.S. foreign tax credit rules require that foreign taxes actually be paid in order to be eligible for the credit.

We hope that this general information will prove helpful to you. This information letter is advisory only and has no binding effect on the Internal Revenue Service. See section 2.04 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 7. For further general information regarding claiming a foreign tax credit, see Publication 514 (Foreign Tax Credit for Individuals). See also Publication 516 (U.S. Government Civilian Employees Stationed Abroad).

Publications 514 and 516 are available on the IRS web site at <http://www.irs.gov/pub/irs-pdf/p514.pdf> and <http://www.irs.gov/pub/irs->

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[pdf/p516.pdf](#), respectively.

Sincerely,

Barbara A. Felker

Chief, Branch 3  
Office of the Associate Chief Counsel  
(International)